



MNQUMA LOCAL MUNICIPALITY

Audit Report

For the year ended 30 June 2019



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Report of the auditor-general to Eastern Cape Provincial Legislature and the Council of Mnquma Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Mnquma Local Municipality set out on pages ... to ..., which comprise of the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, the cash flow statement and statement of comparison of budget with actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Mnquma Local Municipality as at 30 June 2019, and its financial performance and cash flows for the year then ended in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2018 (Act No. 1 of 2018) (Dora).

Basis for qualified opinion

Property, plant and equipment

3. I was unable to obtain sufficient audit evidence that management had properly accounted for property, plant and equipment in accordance with GRAP 17, *Property plant and equipment* as the municipality did not recognise all assets in the financial statements. This is due to some assets not been included in the asset register as confirmed during assets verification. Consequently, I was unable to determine whether any adjustments were necessary to property, plant and equipment were necessary to property, plant and equipment stated at R830,1 million (2018: R831,8 million) as disclosed in note 8 to the financial statements.

Receivables from non-exchange transactions

4. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for receivables for property rates and traffic fines in accordance with GRAP 104, *Financial instruments*. This is due to differences noted between the age analysis and financial statements. I was unable to determine whether any adjustments were necessary to receivables from non-exchange transactions stated at R102,1 million in note 4 to the financial statements.

Payables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence that payables from exchange transactions had been properly accounted as the municipality did not recognise payables from exchange transactions in accordance with GRAP 1, *Presentation of financial statements*. This is

due to the poor status of the accounting records, as differences were noted between the listings and financial statements. I was unable to confirm the payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the payables from exchange transactions of R54,3 million disclosed in the statement of financial position and note 9 to the financial statements.

Revenue from non-exchange transactions

6. The municipality recognised items that did not meet the definition of revenue from conditional grants and subsidies in accordance with GRAP 23, *Revenue from non-exchange transactions*. The municipality recognise revenue from conditional grants without meeting the conditions of the grant. As a result, revenue from non-exchange transactions as disclosed note 22 is overstated by R6,7 million and unspent conditional grants as disclosed in note 11 is understated by the same amount.

General expenditure

7. The municipality did not recognise expenditure in accordance with GRAP 1, *Presentation of financial statements*. This was due to the following:
 - The current year's expenditure is overstated by R33,7 million (2018:4,1 million) due to prior year expenditure that was recorded in the current financial statements.
 - Current year expenditure 4,7million (2018:52,4 million) was not recorded in the financial statements.
8. As a result, general expenditure as disclosed in the statement of financial performance was overstated by R34,0 million (2018: R52,4 million) and accumulated surplus disclosed in the statement of financial position was understated by the same amount.

Expenditure – bulk purchases

9. I was unable to obtain sufficient appropriate audit evidence for bulk purchases, as internal controls had not been established for the monthly amounts billed by the electricity supplier. I could not confirm by alternative means that bulk purchases had been correctly recorded. Consequently, I was unable to determine whether any adjustment was necessary to bulk purchases of R4,83 million disclosed in note 51 to the financial statements.

Irregular expenditure

10. The municipality did not identify and disclose all irregular expenditure in the notes to the financial statements, as required by section 125(2)(d) of the MFMA. Payments made in contravention of the supply chain management (SCM) requirements resulted in undisclosed irregular expenditure of R11,6 million being identified during the audit. I was unable to determine the full extent of the irregular expenditure that should have been disclosed.

Context for the opinion

11. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
12. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and parts 1 and 3 of the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.
13. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty related to going concern

14. I draw attention to the matter below. My opinion is not modified in respect of this matter.
15. I draw attention to note 40 to the financial statements which indicates that the municipality is experiencing financial difficulties in that its current liabilities exceed its current assets. The events or conditions disclosed in note 40, together with other matters set forth in the same note, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue to fund its existing level of operations.

Emphasis of matters

16. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of the corresponding figures

17. As disclosed in note 48 to the financial statements, the corresponding figures for 30 June 2018 were restated as a result of an error in the financial statements of the municipality at, and for the ended, 30 June 2019.

Unauthorised expenditure

18. As disclosed in note 42 to the financial statements, the municipality incurred unauthorised expenditure of R415,28.

Fruitless and wasteful expenditure

19. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R1,55 million was incurred.

Other matter

20. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

21. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Responsibilities of the accounting for the financial statements

22. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
23. In preparing the financial statements, the accounting officer is responsible for assessing the Mnquma Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

24. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
25. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

26. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
27. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

28. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2019:

Key performance areas	Pages in the annual performance report
KPA : Basic services and infrastructure development	x – x

29. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

30. The material findings in respect of the usefulness and reliability of the selected objectives are as follows:

KPA: Basic services and infrastructure development

Reliability

Performance indicators were not verifiable

Number of beneficiaries subsidised with free basic electricity by June 2019

31. The systems and processes that enable reliable reporting of achievement against the indicator were not adequately designed; beneficiaries of free basic electricity were not listed as indigent; duplicates of persons' names, surname and identification number were noted on the indigent register; and beneficiaries were registered with more than one-meter number.

Updated indigent register by June 2019

32. The systems and processes that enable reliable reporting of achievement against the indicator were not adequately designed and duplicates of persons' names, surname and identification number were noted in the indigent register. There were indigents without a unique identification number and/or meter number.

Usefulness

Performance indicators were not well-defined and targets were not specific and measurable

Business plans for 2019-20 MIG funding developed by June 2019

33. The planned target (develop business plans for 2019-20 for MIG funding by June 2019) for this indicator was not measurable. The planned target for this indicator was not specific in clearly identifying the nature and required level of performance and measurable.

Streetlights, high mast and traffic lights assessed and maintained in three municipal towns by June 2019

34. The planned target (assess and maintain street, high mast and traffic lights in three municipal towns by June 2019) for this indicator was not measurable. The planned target for this indicator was not specific in clearly identifying the nature and required level of performance and measurable.

Measures taken to improve performance not corroborated

35. I was unable to obtain sufficient appropriate audit evidence to support the measures taken to improve performance against target as reported in the annual performance report. This was due to limitations placed on the scope of my work. I was unable to confirm the reported measures taken by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported measures taken to improve performance for the indicators listed below:

Indicator description	Planned target	Actual performance
Roads construction: Number of kilometres surfaced in Centane Street by June 2019	(Completion of 1 km of surfaced roads (Centane Street surfacing) by June 2019)	0,55 km
Electrification (grid electrification): Number of households connected by June 2019	Connect 497 households by June 2019	0
Municipal facilities: Completion of DLTC facilitated by June 2019	Completion of DLTC by June 2019	0

Other matters

36. I draw attention to the matters below.

Achievement of planned targets

37. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year and explanations provided for the underachievement of a significant number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 31 to 35 of this report.

Adjustment of material misstatements

38. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of *KPA: Basic*

services and infrastructural development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

39. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

40. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements and annual report

41. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Strategic and performance management

42. The performance management system and related controls were not maintained or were inadequate as they did not describe how the performance planning, monitoring, measurement, review, reporting and improvement processes should be conducted, organised and managed, as required by municipal planning and performance management regulation 7(1).

Consequence management

43. Some of the irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2) of the MFMA.

Assets management

44. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

45. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Revenue management

46. An adequate management, accounting and information system which accounts for debtors, as required by section 64(2)(e) of the MFMA, was not in place.

47. An effective system of internal control for debtors and revenue, as required by section 64(2)(f) of the MFMA, was not in place.

Expenditure management

48. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

49. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R415,28 million, as disclosed in note 42 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. Most of the unauthorised expenditure was caused by non-compliance with the MFMA.

50. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred and the full extent of the irregular expenditure could not be quantified as indicated in the basis for modified paragraph. Most of the disclosed irregular expenditure was caused by non-compliance with SCM regulations and conditional grants being used for purposes other than the intended one by the transerrer.

51. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R4,17 million, as disclosed in note 43 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. Most of the disclosed fruitless and wasteful expenditure was caused by non-compliance with the MFMA.

Liability management

52. An effective system of internal control for liabilities, as required by section 63(2)(c) of the MFMA, was not in place.

Other information

53. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected objectives presented in the annual performance report that have been specifically reported in this auditor's report.

54. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

55. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objectives presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

56. I did not receive other information prior to the date of this auditor's report. When I do receive and read this information and if I conclude that it contains a material misstatement, I am required to communicate the matter to those charged with governance and request that the other information be corrected. I may have to retract this auditor's report and reissue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

57. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
- Leadership did not adequately oversee the internal control environment, as evidenced by repeat findings raised during the audit. Key leadership interventions to address the prior year internal control deficiencies had not been sufficiently implemented and monitored throughout the year. In addition, leadership had not held officials accountable and did not exercise adequate consequence management for non-compliance with policies, procedures and legislation.
 - There has been limited progress in respect of financial disciplines relating to the daily, weekly and monthly processing and reconciliation of transactions, which were not adhered to throughout the financial year. This resulted in inaccurate, incomplete and inadequate financial and performance reporting.
 - Risk management activities were not adequately designed and implemented to mitigate high and pervasive risks at the municipality. Management failed to offer the internal audit unit with the necessary support to provide assurance on internal controls. Consequently, the audit committee did not discharge its legislated mandate effectively.

Other reports

58. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
59. The Hawks are conducting ongoing investigation into allegation of possible fraud and collusion between municipal employees and suppliers in the awarding of contracts.

Auditor-General

East London

30 November 2019



Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected objectives and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Mnquma Local Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease operating as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.

